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Kingdom of the Netherlands—Netherlands

On behalf of
Republic of Armenia, Belgium, Bosnia and Herzegovina, Bulgaria, Republic of Croatia, Cyprus, Georgia, Israel, Luxembourg, Former Yugoslav Republic of Macedonia, Republic of Moldova, Montenegro, Kingdom of the Netherlands—Netherlands, Romania, and Ukraine

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on behalf of
Armenia, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Georgia, Israel, Luxembourg, Former Yugoslav Republic of Macedonia, Moldova, Montenegro, the Netherlands, Romania and Ukraine
at the 33rd International Monetary and Financial Committee
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Global Economic and Financial Prospects and Policies

The recovery continues but we need better management of expectations…
With 3,2% growth in 2016 and 3,5% growth in 2017 the global economy is expected to reach the historic world average of 3,5%. The recovery in the Euro area continues and is broad based, with all countries projected to experience positive growth in 2017. The recovery is supported by improved labor market conditions and pay-offs from earlier structural reforms. The Chinese economy has slowed down from very high growth levels but its further expansion is expected to be more sustainable going forward. Growth in a number of other large emerging market economies, such as India and Indonesia, remains strong.

Pessimism on global growth at the current juncture seems to be driven partly by events on financial markets in early 2016, which featured an unusual high degree of volatility. In our view the magnitude of this volatility did not reflect the underlying fundamentals of the global economy, although fundamental changes in financial markets – such as lower levels of liquidity - could contribute to structurally higher levels of volatility.

Yet volatility can also be seen as a byproduct of progress towards achieving more sustainable growth. One example concerns China: while uncertainty on the direction of Chinese policies may have led to excessive volatility, the necessary transition to a sustainable growth model will inevitably generate periodic shocks in financial markets. Another example concerns the euro area: it has over the past few years made substantial steps to strengthen its financial sector, especially its banks. The coming into force of new bail-in rules in 2016 requires bank liability holders to fully internalize and price bail-in risks. While increasing awareness among investors creates (temporary) volatility, such price movements might be considered as an initial indication that rules we designed to reduce the need for bailouts funded by taxpayers work.

Better management of expectations can limit financial market volatility. We should avoid increasing policy and regulatory uncertainty, by leaving no doubt that we will implement the rules of our agreed regulation. Banks are confronted with challenges to their business model but any possible weakening of recently approved banking regulation will likely have the opposite effect of reducing confidence. And we should finish what we started, by implementing the agreement on total loss absorption capacity (TLAC) and, for the euro area, by completing the banking union.

Better management of expectations is also necessary regarding the real economy. In advanced economies shrinking potential output growth is a long-term trend. In emerging market economies it has also decreased over the past years. Hence lower growth and/or downgrades of growth forecasts should not solely lead to calls for additional macro-economic stimulus but require a reassessment of the degree of realism in the initial expectations of some. We subscribe to a comprehensive growth strategy where monetary, fiscal and structural policies are mutually reinforcing to support growth and stabilityhowever if we want to sustainably raise growth, we will need to focus on further structural reforms.

…and a policy mix with more attention for structural reforms and the composition of fiscal policy
This Constituency has repeatedly argued that a return to strong, sustainable and balanced growth is impossible without walking the extra mile on structural reforms. As monetary policy alone cannot generate growth and public debt is already high in various countries, various countries have over

the past few years increased their efforts to strengthen their economy through structural reforms. This should enable a policy mix without too much weight on monetary accommodation. At the same time there is scope to further step up structural reform efforts in most countries.

While the positive effects of various structural reforms can take some time to manifest, structural reforms are the only durable medicines that can generate growth and raise employment in a sustainable way. In addition to increasing potential output, structural reforms can also have various other benefits. These include:

1. Increasing the flexibility of economies, which makes them more resilient to shocks.
2. Various structural reforms can boost short term growth by increasing confidence and boosting future earnings expectations. Specific reforms in overregulated product markets also offer fresh investment opportunities. This calls for well-designed, well-sequenced and credible reform packages.
3. If well chosen, structural reforms can lead to a simultaneous reduction in inequality and, especially in the case of Europe, a reinforcement of its social model. For example, better and more accessible education will not only increase labour productivity but will also improve social mobility.

Adequate communication on the merits of structural reforms is important to increase public support and, by taking into account country specific circumstances, improve country ownership. Taking into account country specific circumstances would imply for example a focus for the euro area on reducing the tax wedge and improving insolvency regimes, for the US on increasing labor participation by active labor market policies, for China on enforcing market discipline on state owned enterprises, for emerging market economies on dismantling bottlenecks for infrastructure investment and for low-income economies on measures geared towards increassing economic diversification.

Given the importance of structural reforms, we welcome the IMF's empirical analysis on the macroeconomic effects of reforms. The IMF proposes better sequencing and prioritizing of structural reforms based on the business cycle and available monetary and fiscal space. At the same time, policymakers need to use the current momentum for reform. Hence, calls for proper sequencing and sufficient macro-economic accommodation should not result in delays and eventual annulation of necessary reforms. Strong growth performances of various euro area programme countries in the last few years illustrate that a credible package of structural reforms can have positive effects, also in the short run. Packaging of reforms, such as a combination of labor and product market reforms, enables policy makers to smooth possible adverse effects for specific groups in society.

Prudent fiscal policies should remain another element of a well-balanced and growth friendly policy mix. We call for caution when using expansionary fiscal policy. Many countries already have high public debt. This increases vulnerability in the face of future shocks and could damage growth through confidence effects. In order to increase resilience, reducing public debt levels should remain high on the agenda.

Alternatively, countries can stimulate growth by improving the quality of public finance. This includes adjusting the composition of public expenditures and taxes towards growth friendly budget items but also working on the efficiency of public expenditures to have a bigger bang for the buck. Such steps can for example lead to both increased and better spending on public infrastructure. This will, together with measures that stimulate private investment, increase countries' capital stock and potential output. At the same time we caution against generic statements on the potential of additional public infrastructure investment to increase growth. Country circumstances should be taken into account and traditional quality standards for projects should be maintained.

IMF policy issues

The functioning of the International Monetary System

Since the last IMFC meeting in Lima, several important steps have been taken that contribute to a more robust and effective International Monetary System (IMS). Our Constituency very much welcomes the entry into effect of the 2010 quota and governance reforms. The doubling of quota resources ensures that the IMF is less dependent on temporary borrowed resources, while the redistribution of quotas to EMDCs and the move to an all-elected Board strengthen the legitimacy of the Fund. Furthermore, the decision of the Executive Board to include the renminbi in the SDR-basket as of October 2016 will ensure that the composition of the basket better reflects the global reserve currencies used in the IMS. We also welcome the recently approved reform of the lending framework for programs with exceptional access support; our Constituency has been very supportive of this proposal from the start. The reform strengthens the IMF's policy on sovereign debt restructuring by increasing the flexibility for the Fund to provide financing on the condition of a reprofiling of existing claims and by enhancing market discipline through the involvement of private creditors.

Our Constituency sees scope to further strengthen the IMS, but we encourage the IMF to focus on several key issues. First of all, stronger domestic policy frameworks and deeper financial markets are a key priority for the Fund in order to increase the resilience to shocks, in particular in emerging and developing countries. The IMF should thus provide the right incentives at the national, regional and global level with candid surveillance. Adequate macroeconomic and financial policies, including structural reforms, are a first priority against shocks in the broader context of the IMS. The Fund could also conduct further analytical work and monitoring to deepen its knowledge on capital flows in close cooperation with the BIS, FSB and OECD. The IMF should encourage its members to continue policies aimed at opening up financial accounts and liberalizing capital markets. Capital flow management ought to be seen as a policy tool to address financial stability risks only when excess (volatility) in financial flows cannot be reduced by macro-economic adjustment. They should be used with caution and on a temporary basis.

Adequacy of the global financial safety net

The GFSN is a crucial component of the IMS as it ensures that all countries have potential access to liquidity support in reserve currencies to address external funding crises. The GFSN has been significantly strengthened in size since the global financial crisis and the composition has evolved by adapting to new circumstances and incorporating key lessons from the crisis. Our Constituency is of the view that there is currently no need to question the adequacy of the size of the GFSN for both the short- and medium-term. The discussion on the GFSN should primarily address the question whether its composition is adequate and whether all countries have sufficient access.

Given that not all countries are prone to the same type and size of shocks, due to structural differences, there is a logic for the GFSN to consist of multiple layers that address a broad range of risks. The euro area has significantly strengthened its safety net for several components, with the establishment of the ESM. Several other regions have also set up their own Regional Financing Arrangement (RFA), although these remain largely untested. Some countries have relied more on self-insurance to prevent risks from materializing. Developing countries' access is mostly limited to the IMF. In our Constituency's view it is important that all IMF members have sufficient access to liquidity support of the GFSN.

The role of the IMF in the IMS and GFSN

The IMF has a central role in the GFSN. Due to the strengthening of the IMF's surveillance capacity, the expansion of the lending toolkit with precautionary instruments and the increased access limits, the Fund's position in the GFSN is stronger today. At the same time, this role can be further strengthened. The Fund can contribute to the cooperation between the different actors within the GFSN. This in particular applies to the cooperation with RFAs. The IMF could use its technical expertise to provide assistance to RFAs, in order to strengthen their institutional functioning and lending operations. Since RFAs are heterogeneous, it is important that measures to strengthen

cooperation take into account differences in mandates and respect the independence of RFAs. The IMF, through its programs and surveillance capacity, can address moral hazard within the GFSN, by ensuring that financial support is accompanied by policy incentives to prevent new risks from materializing. The IMF should ensure that appropriate conditionalities continue to be set for all types of programs. The Fund should use the flexibility within the current lending toolkit, in order to tailor support to country-specific needs.

The resources of the IMF make up an essential part of the GFSN. Our Constituency has committed itself to a Fund with an adequate size. The current level of resources provides a large buffer against downside risks. As it currently stands, we do not see a need to increase the Fund's lending capacity. We expect several measures to decrease the demand for IMF resources, including the recent reform to the Fund's lending framework for exceptional access programs and financial regulatory reforms (in particular more effective bank resolution regimes), that reduce the likelihood and/or cost of financial sector crises. We also stress that the 2012 bilateral borrowing agreements were set up as a temporary credit arrangement at an exceptional time when there was a pressing need for an increase in IMF resources and that these have been predominantly provided by European members. A renewal of the bilateral agreements as a bridge towards the quota resources and NAB should not be taken for granted.

Our Constituency finds it important that the IMF remains a quota-based institution, since quotas underpin the Fund's governance by anchoring voting power of members. They also underpin the Fund's finances and ensure that the burden of providing resources is shared between members. In this context, we look forward to the discussions on the 15th review of quotas and are committed to reaching an agreement by the Annual Meetings in 2017. We reiterate the IMFC's commitment to treat the 15th review of quotas and the review of the quota formula as an integrated package. GDP and openness must remain the two main variables in the formula as they best capture the role and mandate of the Fund. The methodology of openness should remain unchanged and its weight in the formula should at least be maintained.

IMF lending

In our Constituency, Armenia, Georgia and Ukraine currently have a financial arrangement with the Fund. Ukraine is currently implementing a comprehensive program of adjustment and reforms with strong support of the IMF. The first review has been successfully completed and the process of the second review is currently ongoing. Cyprus has successfully exited the IMF program. We would like to thank the Fund for its continued support.